FILE COPY

S. ...
JUL 8 ...73
...LE

# In The
# Supreme Court Of The United States

OCTOBER TERM, 1973

No. 72-1658

**C & M PETROLEUM PRODUCERS, INC.; HERMAN MORRIS; DAVE MADRAY; AND HERSHELL COLLINS,**
*Petitioners,*

**vs.**

**JOHN C. MEYERS and LUCY B. MEYERS; JOHNNY DEAL; BILLY G. TILLMAN; H. LEHMAN FRANKLIN, JR.,**
*Respondents.*

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.**

## BRIEF IN OPPOSITION

Wyckliffe A. Knox, Jr.
Post Office Box 1564
Augusta, Georgia 30903
*Counsel for Petitioners*

Of Counsel:
Hull, Towill, Norman, Barrett & Johnson
Post Office Box 1564
Augusta, Georgia 30903
H. Lehman Franklin, Jr.
Post Office Box 964
Statesboro, Georgia 30458

## INDEX


| | Page |
|---|---|
| Statement of The Case | 1 |
| Question Presented | 3 |
| Argument | 4 |
| Conclusion | 14 |


### Table of Authorities

### Cases


**Can-Am Petroleum Company** v. **Beck,** 331 F.2d 371 (10th Cir. 1964) ... 5, 6

**Henderson** v. **Hayden, Stone, Inc.,** 461 F.2d 1069 (5th Cir. 1972) ... 6

**Kaiser-Frazer Corp.** v. **Otis & Co.,** 195 F.2d 838 (2d Cir. 1952) ... 6, 7

**Lynn v. Caraway,** 252 F. Supp. 858 (W.D. La. 1966); 379 F.2d 943 (5th Cir. 1967) ... 5

**Nathanson** v. **Weis, Voisin & Cannon, Inc.,** 325 F. Supp. 50 (S.D. N.Y. 1971) ... 14

**Pearlstein** v. **Scudder & German,** 295 F.Supp. 1197 (S.D. N.Y. 1968) ... 11, 12

**Pearlstein** v. **Scudder & German,** 429 F.2d 1136 (2d Cir. 1970); cert. denied 401 U.S. 1013, 28 L ed 2d 550 ... 11, 12

**Perma Life Mufflers Inc. v. International Parts Corp.**, 392 U.S. 134, 20 L ed 2d 982, 88 S.Ct. 1981 ..... 13, 14

**Repass v. Rees,** 174 F.Supp. 898 (D. Colo. 1959) ..... 9

**Royal Air Properties, Inc. v. Smith,** 312 F.2d 210 (9th Cir. 1964) ..... 7

**Straley v. Universal Uranium and Milling Corporation,** 289 F.2d 370 (9th Cir. 1961) ..... 7, 8

**Wilko v. Swan,** 346 U.S. 427, 98 L ed 168 (1953) ..... 4

**Woodward v. Wright,** 226 F.2d 108 (10th Cir. 1959) ..... 10

**Statutes**

Securities Act of 1933 (15 U.S.C.):
Section 5 (15 U.S.C. §77e) ..... 1, 3, 5, 8, 9

Section 12(1) (15 U.S.C. §77l) ..... 5, 8, 9, 10

Section 14 (15 U.S.C. §77n) ..... 4, 5, 8, 10

Securities Exchange Act of 1934 (15 U.S.C.):
Section 29(a) (15 U.S.C. §78cc(a) ) ..... 7, 11, 12, 13

**Textbooks and Others**

Jennings and Marsh, **Securities Regulation, Cases and Materials** (2d ed. 1968), p. 813 ..... 8, 9

Loss, **Securities Regulation,** vol. 3, (2d ed. 1961), pp. 1693, 1816 ..... 10

# In The
# Supreme Court Of The United States

OCTOBER TERM, 1973

No. 72-1658

C & M PETROLEUM PRODUCERS, INC.; HERMAN MORRIS; DAVE MADRAY; AND HERSHELL COLLINS,
*Petitioners,*

vs.

JOHN C. MEYERS and LUCY B. MEYERS; JOHNNY DEAL; BILLY G. TILLMAN; H. LEHMAN FRANKLIN, JR.,
*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

## BRIEF IN OPPOSITION

## STATEMENT OF THE CASE

During 1968, the Petitioners (hereinafter "Sellers") began offering for sale in interstate commerce, working interests in oil wells located in Ohio. These securities were so offered and sold in violation of section 5 of the Securities Act of 1933 since no regis-

tration statement as required by that statute had been filed at the time of offer and sale. The securities were also sold in violation of the Georgia Securities Act of 1957.

Once the Sellers were informed of the violations of the Securities Act of 1933 and the Georgia Securities Act of 1957 due to the unregistered status of the securities, they wrote to the Respondents (hereinafter "Purchasers") on May 27, 1969 advising them of the violation of the federal and state statutes and offering to repurchase their interests in the wells. The letter stated that unless reply was received within ten days, it would be assumed that the offer was rejected. The full text of the letter is quoted in the opinion of the Court of Appeals. On May 30, 1969, Lehman Franklin, Jr., one of the purchasers and attorney for the other purchasers, wrote a letter to Herman Morris, officer and agent of C & M Petroleum, stating the impossibility of accepting or rejecting the repurchase offer at that time and requesting certain investment information concerning the securities. The information sought was such that would have been normally revealed in a registration statement and prospectus had such accompanied either the original offering of the securities or the rescission letters.

Failing to receive the information requested, the Purchasers were unable to make an intelligent evaluation of the matter or an informed decision, particularly within the arbitrary ten day time limit imposed by the Sellers. The absence of the information requested also prevented the Sellers from evaluating the exaggerated press accounts and promotional literature concerning the securities at the time the rescis-

sion offers were made.

Not knowing the true value of their securities, the Purchasers made no decision in response to the rescission letters other than to request further information. When the information was not forthcoming and the rescission offers were subsequently withdrawn, the Purchasers commenced their actions in the United States District Court for the Southern District of Georgia.

The District Court submitted the case to the jury on the question as to whether or not the Purchasers had waived the right to the return of their money. After an affirmative finding by the jury, the Purchasers appealed to the Circuit Court which reversed and remanded the case with directions for judgment to enter in favor of the Purchasers holding that waiver is not a defense under the Securities Act of 1933.

## QUESTION PRESENTED

The question presented in this case is whether a purchaser of securities sold in violation of section 5 of the Securities Act of 1933, may, within the applicable statute of limitations, but before the commencement of litigation, effectively waive his rights to obtain a return of his investment by failing to accept a rescission offer within an arbitrary period of ten days.

## ARGUMENT

### A. THE DECISION OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT IS IN HARMONY WITH EXISTING FEDERAL LAW.

The Court of Appeals held that section 14 of the Securities Act of 1933, 15 U.S.C. §77(n), prohibits a waiver of a purchaser's rights to recoup his investment if unregistered securities are sold to him. By so holding, the Court of Appeals not only reaffirmed its previous pronouncements upon the subject of waiver under the 1933 Act, but it also followed the established federal law on the subject.

In **Wilko v. Swan,**[1] the Supreme Court invoked the nonwaiver provisions of section 14 of the 1933 Act to invalidate a customer's margin agreement binding him to arbitration in the event of a controversy with a securities firm. Illustrative of the different "rules" applicable to the purchasers of securities is the following commentary by the Court on section 14 of the Act:

> ". . . We think the right to select the judicial forum is the kind of "provision" that cannot be waived under §14 of the Securities Act. . . . While a buyer and seller of securities under some circumstances may deal at arm's length on equal terms, it is clear that the Securities Act was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate and appraise the prospective earnings and business plans affecting securities than buyers. It is therefore reasonable for Congress to put buyers of securities covered by the Act on a different

[1] 346 U.S. 427, 98 L ed 168 (1953)

basis from other purchasers.

> When the security buyer, prior to any violation of the Securities Acts, waives his rights to sue in courts, he gives up more than would a participant in other business transactions. The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary."[2]

The Securities Act of 1933, both in its affirmative requirements of registration and prohibitions against a waiver of compliance, has been tightly and literally construed by the courts. Section 12 of the Act has been held to provide virtually absolute liability, the only defense to which being allegation and proof by the defendant that the particular security or transaction was exempt from the provisions of section 5[3]. The foregoing holding by the District Court for the Western District of Louisiana was expressly approved by the Fifth Circuit Court of Appeals in a per curiam opinion.[4]

Not only is the holding by the Fifth Circuit in the present case in harmony with the previous decisions of the Supreme Court and the Fifth Circuit, but it is likewise in harmony with the overwhelming weight of authority on this question.

The opinion of the Fifth Circuit follows the holding of the Tenth Circuit in **Can-Am Petroleum Company v. Beck**[5], wherein it was held that the remedial

[2] 346 U.S. at 435, 98 L ed at 175
[3] Lynn v. Caraway, 252 F.Supp. 858 (W.D. La. 1966)
[4] Lynn v. Caraway, 379 F.2d 943 (5th Cir. 1967)
[5] 331 F.2d 371 (10th Cir. 1964)

aspects of the Securities Act could not be waived, directly or indirectly. In **Can-Am,** as in the instant case, undivided interests in oil wells were offered and sold without registration. One purchaser, Mrs. Beck, became involved in promotional efforts to others and when she filed suit to obtain a return of her investment the sellers contended that she was prevented from doing so because she was **in pari delicto** with them. In rejecting such a defense, the Tenth Circuit held that an investor does not lose the shelter of the Act because he becomes to some extent involved in the illegality of the security sales, citing as its reason "the public interest in the enforcement of the Securities Act" which "outweighs any equitable barriers to recovery by a purchaser of unregistered securities".

The Fifth Circuit has reaffirmed the rejection of equitable defenses in its recent decision, **Henderson v. Hayden, Stone, Inc.**[6] There the seller of unregistered securities attempted to defeat recovery by asserting an estoppel arising from the investor's expertise and sophistication as a trader. In rejecting such a defense, the court recognized the investors lack of innocence but held:

> "Congress sought to encourage sellers of securities to register those securities prior to any sales or offers to sell. By allowing recoveries such as the one in this case, unregistered sales are discouraged."

The foregoing philosophy underlying the 1933 Act has also been enunciated by the United States Court of Appeals for the Second Circuit. In **Kaiser-Frazer Corp. v. Otis & Co.,**[7] the court considered a situation

[6] 461 F.2d 1069 (5th Cir. 1972)
[7] 195 F.2d 838 (2d Cir. 1952)

where Kaiser-Frazer sought damages from an underwriter who, at the eleventh hour, refused consummation of an underwriting agreement citing misrepresentations in the prospectus as to earnings and an error in the opinion of counsel as to pending litigation. Kaiser-Frazer countered that the underwriter was estopped or had waived such a defense because it had full knowledge of all the facts, not only at the time of the underwriting agreement, but also as a result of independent investigations, and could not rely upon such facts as constituting a breach of warranty. The Second Circuit permitted no recovery on the contract because of its illegal nature and stated:

> "But whatever the rules of estoppel or waiver may be in the case of an ordinary contract of sale, nevertheless it is clear that a contract which violates the laws of the United States and contravenes the public policy as expressed in those laws, is unenforceable . . . This is so regardless of the equities as between the parties for the very meaning of public policy is the interest of others than the parties and that interest is not to be at the mercy of the defendant alone."

The Sellers contend that two decisions of the Ninth Circuit, **Straley** v. **Universal Uranium and Milling Corporation,**[8] and **Royal Air Properties, Inc.** v. **Smith,**[9] are contrary to the decision of the Fifth Circuit. **Royal Air** differs factually from the instant case as it was based upon a violation of section 10(b) of the Securities Exchange Act of 1934 and Rule X-10 (b)-5 of the Securities & Exchange Commission for misrepresentation in the sale of stock. In that case, where no overriding policy consideration such as the

[8] 289 F.2d 370 (9th Cir. 1961)
[9] 312 F.2d 210 (9th Cir. 1964)

nonregistration of securities was involved, but rather only a misrepresentation as between the parties, the court allowed consideration of the defense of waiver but held that the facts did not support a waiver. In **Straley,** stock was purchased in a Nevada uranium mining venture in November of 1955. In January 1956, the purchasers became aware that the stock had been sold in violation of the Securities Act. In March, and again in May, the purchasers voted for a merger and in July, and again in October, they exchanged their shares for stock in the successor corporation. In November 1956, the value of the securities drastically dropped. On November 20, 1956, one day before the statute of limitations expired, suit was commenced. The District Court concluded that recovery was prevented by the equitable doctrine of laches. The Ninth Circuit reversed, holding that the equitable defense of laches was unavailable as a bar to recovery under the Securities Act. Subsequently, the Ninth Circuit opinion discusses the **possible** application of waiver and estoppel as a defense but this discussion is purely **obiter dictum,** not essential to or involved with the decision and therefore not binding authority, as the sellers claim, that purchasers' rights under section 12(1) may be waived.

The imposition of absolute liability for a violation of section 5 has earned wide acceptance by noted commentators and has enjoyed increasing judicial approval. Professors Jennings and Marsh are counted among the adherents to the absolute liability position.

> "§12(1) of the Securities Act of 1933 imposes civil liability for sale of a security in violation of §5 of the Act. The liability is absolute, there being no defense except to show that the sale was not

in violation of §5. Even if a prospectus were prepared truthfully containing all of the information required by the Act and were delivered to the vendee, this fact would be totally immaterial in an action under §12(1), unless it were part of an effective registration statement. Thus §12(1) gives the vendee of a security sold in violation of §5 an unqualified 'put' of the security back to the vendor within the period of the statute of limitations at the purchase price." Jennings and Marsh, **Securities Regulation, Cases and Materials,** 813 (2d. ed. 1968).

And, as Professor Loss has observed in his respected treatise,

> "Liability under §12(1) is virtually absolute. The plaintiff need only allege and prove (1) that the defendant was a seller, or under §15, a person in control of a seller; (2) that the mails or some means of transportation or communication in interstate commerce was used, not just in connection with the offering of the security generally but in the offer or sale to the particular plaintiff; (3) that the defendant failed to comply with either the registration or the prospectus requirement; (4) that the action is not barred by the statute of limitations; and (5) that adequate tender was made when the plaintiff is seeking rescission.
>
> The only defense then available to the defendant is to allege and prove that the particular security or transaction was exempt from §5." 3 Loss, **Securities Regulation,** 1693 (2d. ed. 1961).

An exemption from the section 5 requirements was found to be the only defense to an action for the return of an investment in oil and gas leases in **Repass v. Rees**[10] where the court concluded that the defend-

[10]174 F. Supp. 898 (D. Colo. 1959)

ants committed a violation of the Securities Act of 1933, and that their liability under section 12 of the Act was absolute, no exemption from the registration requirements having been proved.

The doctrine of absolute liability has also been accepted by the Tenth Circuit. That court, in **Woodward v. Wright,** [11] found the congressional purpose to require a registration statement with the offer or sale of securities to the general public and the imposition of absolute liability for failure to register nonexempt transactions.

B. THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT REFLECTS THE CORRECT APPLICATION OF §14 OF THE SECURITIES ACT OF 1933.

The Sellers argue that certiorari should be granted because section 14 of the Act only prohibits an "anticipatory" type waiver and furthermore that a prohibition of all waivers would prevent civil litigants from effecting a settlement of a section 12(1) case.

The instant case does not involve an "anticipatory" agreement to waive rights such as a court hearing, rather, the Sellers of the securities seek to imply a waiver of the benefits of the Act from the events surrounding the rescission offers. Assuming **arguendo** the distinction between an agreement to waive a future controversy ("anticipatory") as opposed to a matured controversy, it is clear from the facts that the controversy had not in fact matured at the time

[11] 226 F.2d 108 (10th Cir. 1959)

the events claimed to be a waiver took place. The Purchasers had not instituted suit nor had they demanded payment. The Sellers did not alert the Purchasers that the right of rescission should be accepted within the arbitrarily imposed ten day limit failing which the right would be waived. The parties had not assumed adversary positions.

The Securities Act of 1933 does not prevent the settlement of litigation. It does, however, prohibit the unintentional or involuntary relinquishment of the right of reimbursement.

The Sellers cite the case of **Pearlstein** v. **Scudder & German,** 295 F.Supp. 1197 (S.D. N.Y. 1968), as authority for the proposition that "stipulations agreed to after the existence of a controversy under the Securities Exchange Act of 1934 are valid and enforceable notwithstanding §29(a) of that Act".[12] The foregoing decision is not such authority because it has been reversed by the Second Circuit.[13] **Pearlstein** involved a violation of the 1934 Act rather than the 1933 Act (the violation of margin requirements and Regulation T of the Federal Reserve System relating to timely payment for purchases). In the decision which the Sellers cite, the lower court had held that certain stipulations of settlement in a state court action barred the action under consideration which resulted from a violation of the Federal Act. In reversing the lower court and declaring void such a purported waiver, the Second Circuit again recognized the following overriding policy considerations which prohibit waivers:

---

[12]page 9 of petition

[13]**Pearlstein** v. **Scudder & German,** 429 F.2d 1136 (2d Cir. 1970); cert. denied 401 U.S. 1013, 28 L ed 2d 550.

a. The value of the private action to the enforcement of the securities laws ("in our view, the danger of permitting a windfall to an unscrupulous investor is outweighed by the salutary policing effect which the threat of private suits for compensatory damages can have upon brokers and dealers above and beyond the threats of governmental action by the Securities & Exchange Commission")[14].

b. The value of encouraging private actions to force sellers or brokers to shoulder the responsibility Congress has placed upon them.

c. The allowance of waivers would serve only to legalize the actions which private suits serve to discipline.

In commenting upon section 29(a) of the 1934 Act, the Court stated:

> "Section 29(a) of the Securities Exchange Act holds void any stipulation obligating a party to waive compliance with the Act. Although the lower court held that waivers of rights under the Act may be given effect if the waivers occur after the commencement of suit, the cases cited only stand for the proposition that the remedial right of access to the courts after an act of controversy has arisen can be waived knowingly in favor of arbitration. Here it is difficult to say that Pearlstein's waiver was knowing given the apparent lack of inducement to give up his rights other than financial pressure. But if the waiver were knowing, it would not secure some desirable end such as arbitration easily compatible with the broad purpose of the Act but would instead only

[14] 429 F.2d at 1141

serve to legalize the very extension of credit which the margin requirements seek to prevent and which suits such as this one serve to discipline." (emphasis supplied).

Thus it is clear from the authorities cited by the Sellers that even under the 1934 Act, a purported waiver, which must occur after commencement of suit, is effective only in favor of arbitration, and is ineffective and void where the end accomplished thereby would serve only to legalize a violation of the Act.

In the instant case there has been no express waiver of rights nor an agreement to arbitrate, only a request by the Purchasers for information with which to evaluate the proffered rescission. A waiver under such circumstances is not only incompatible with the broad purposes of the Act but, to the contrary, serves only to legalize the sale of nonregistered securities. If rights can be so easily extinguished then no seller of securities would feel obligated to register, safe in the knowledge that he could protect himself from civil liability by simply offering a rescission once a violation became discovered, all the while withholding the information required by the Act and necessary for an intelligent decision by the public both upon the merits of the investment or the rescission offer. Indeed such a result would thwart the public policy commanding the registration of securities.

The Supreme Court has indicated the inappropriateness of invoking broad common law barriers to relief where a private suit serves important public purposes. In **Perma Life Mufflers Inc. v. International**

**Parts Corp.**[15] The court rejected the equitable defense of **in pari delicto** to a treble damage action brought by a plaintiff under the antitrust statutes.[16]

The reasoning of the Supreme Court has been applied to a securities case in **Nathanson v. Weis, Voisin & Cannon, Inc.**[17] in which the United States District Court for the Southern District of New York concluded that the defense of **in pari delicto** to a securities case must yield to the overriding policy considerations in order to secure effective enforcement of the antifraud provisions of the Securities Acts.

## CONCLUSION

Therefore, the Fifth Circuit was correct in holding a waiver of benefits unavailable under section 14 of the 1933 Act. That decision reflects the recognition that the right of private actions be scrupulously preserved against relinquishment. Otherwise, the interest which both individuals and the community at large have in the effective enforcement of the regulations of securities markets will be undermined. In so holding, the Fifth Circuit was both correct and in harmony with the authorities and the trend of federal law. For these reasons, it is respectfully urged that the Su-

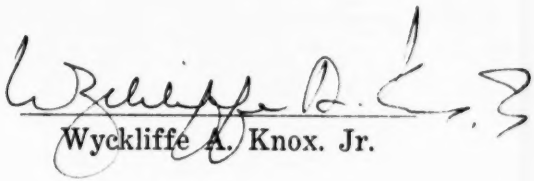
---

[15] 392 U.S. 134, 20 L ed 2d 982, 88 S.Ct. 1981

[16] "The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant but the law encourages his suit to further the overriding public policy in favor of competition. A more fastidious regard for the relative moral worth of the parties would result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement and permitting the plaintiff to recover a windfall gain does not encourage continued violations by those in his position since they remain subject to civil and criminal penalties for their own illegal conduct . . ."

[17] 325 F.Supp. 50 (S.D. N.Y. 1971)

preme Court should not issue a writ of certiorari to the United States Court of Appeals for the Fifth Circuit.



Wyckliffe A. Knox. Jr.

## CERTIFICATE OF SERVICE

I hereby certify that I have this day served counsel of record for the petitioners, John B. Miller, Post Office Box 8426, Savannah, Georgia 31402 with three copies of the within and foregoing brief by mail by depositing same in the United States Post Office or mail box with first class postage prepaid, addressed as above indicated.

This 6th day of July, 1973.

Wyckliffe A. Knox. Jr.